

Letter of Findings: 04-20110523
Sales and Use Tax
For the Tax Years 2008-2009

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ISSUE

I. Sales and Use Tax—Manufacturing Exemption.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-5; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; IC § 6-2.5-5-30; IC § 6-8.1-5-1; [45 IAC 2.2-4-13](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-9](#); [45 IAC 2.2-5-12](#); [326 IAC 2-1.1](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Rhoads v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); General Motors Corp. v. Indiana Dep't. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Mumma Bros. Drilling Co. v. Dep't of Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); Indiana Dep't. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); Indiana Dep't of State Revenue v. American Dairy of Evansville, Inc., 338 N.E.2d 698 (Ind. Ct. App. 1975); Indiana Dep't of Revenue v. Interstate Warehousing, Inc., 783 N.E.2d 248 (Ind. 2003); Graham Creek Farms v. Indiana Dep't of State Revenue, 819 N.E.2d 151 (Ind. Tax Ct. 2004); Letter of Findings 04-20090196 (November 12, 2009); Letter of Findings 04-20080141 (September 29, 2008); Letter of Findings 04-20070529 (August 25, 2008); Letter of Findings 04-20100634 (June 28, 2011).

Taxpayer protests the imposition of use tax.

STATEMENT OF FACTS

Taxpayer owns and operates two aggregate plants and several concrete plants in Indiana. As a result of audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional use tax and made assessments of use tax and interest for the 2008 and 2009 tax years. The Department found that Taxpayer had made a variety of purchases on which neither sales tax was paid at the time of purchase nor was use tax remitted to the Department. Taxpayer protested. A hearing was held, and this Letter of Findings results. Additional facts will be provided as necessary.

I. Sales and Use Tax—Manufacturing Exemption.

DISCUSSION

On initial review, the Department found that Taxpayer had made a variety of purchases without properly paying sales tax at the time of purchase and assessed use tax on the purchases. Taxpayer asserts that certain of its purchases are not subject to use tax because the purchases would qualify for the manufacturing equipment exemption as found in IC § 6-2.5-5-3.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoads v. Indiana Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8\(a\)](#). An exemption from use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional exemptions from sales tax and use tax. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "Exemption statutes are strictly construed because an exemption releases property from the obligation of bearing its fair share of the cost of government." General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991) aff'd 599 N.E.2d 588 (Ind. 1992) (Internal citations omitted). Thus, "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." RCA, 310 N.E.2d at 101. Accordingly, the taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. General Motors, 578 N.E.2d at 404.

IC § 6-2.5-5-3(b) provides:

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. (Emphasis added).

Thus, the legislature granted Indiana manufacturers a sales tax exemption for certain purchases, which are for "direct use in direct production, manufacture... of other tangible personal property." In enacting the exemption, the legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer purchases for use within its manufacturing facility. "Fairly read, the exemption was meant to apply to capital equipment that meets the 'double direct' test." *Mumma Bros. Drilling Co. v. Dep't of Revenue*, 411 N.E.2d 676, 678 (Ind. Ct. App. 1980). The capital equipment "in order to be exempt, must (1) be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." *Indiana Dep't. of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983). "The test for directness requires the equipment to have an 'immediate link with the product being produced.'" *Id.* Accordingly, the sales tax exemption is applicable to that equipment which meets the "double direct" test and is "essential and integral" to the manufacture of taxpayer's tangible personal property. *General Motors*, 578 N.E.2d at 401. The application of Indiana's double-direct manufacturing exemptions often varies based on a determination of when a taxpayer's manufacturing process is considered to have begun and ended.

An exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. [45 IAC 2.2-5-8\(a\)](#). Machinery, tools, and equipment acquired for "direct use in the direct production" is defined in [45 IAC 2.2-5-8\(c\)](#) as "manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process" that have "an immediate effect on the article being produced." Property has "an immediate effect" when it becomes "an essential and integral part of the integrated process which produces tangible personal property." [45 IAC 2.2-5-8\(c\)](#). [45 IAC 2.2-5-8\(d\)](#) excludes pre-production and post production activities by providing that "'direct use in the production process' begins at the point of first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its complete form."

[45 IAC 2.2-5-8\(g\)](#) further states:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

Additionally, [45 IAC 2.2-5-8 \(j\)](#) provides:

Machinery, tools, and equipment used in managerial sales, research, and development, or other non-operational activities, are not directly used in manufacturing and, therefore, are subject to tax. This category includes, but is not limited to, tangible personal property used in any of the following activities: management and administration; selling and marketing; exhibition of manufactured or processed products; safety or fire prevention equipment which does not have an immediate effect on the product; space heating; ventilation and cooling for general temperature control; illumination; heating equipment for general temperature control; and shipping and loading.

Accordingly, tangible personal property purchased for the use in the production of a manufactured good is subject to sales and use tax unless the property has an immediate effect on and is essential to the production of the marketable good. Thus, it is only the property that has an immediate effect on and is essential to the production that is directly used in the direct production of a marketable good and is exempt.

The issue is where Taxpayer's production process begins. Initially, the Department's audit determined that Taxpayer's concrete manufacturing production process did not begin until the raw materials were placed in the concrete trucks and concluded that the batch plant equipment was taxable except for a partial exemption that was granted based upon a determination that Taxpayer's concrete manufacturing process was "integrated" with its aggregate production process.

However, the Department's audit determination of the "integrated process" is incorrect due to its misapplication of *Cave Stone* and *General Motors*. Taxpayer's aggregate plants and concrete plants are two separate and distinct manufacturing processes and are not part of the same "integrated production process." The Department's audit took too broad a view of Taxpayer's aggregate and concrete production processes. In *General Motors*, 599 N.E.2d 588 (Ind. 1992), the Indiana Supreme Court addressed the issue of whether the petitioner's manufacturing plants constituted a continuous, integrated production process. In *General Motors*, the automobile

manufacturer shipped component automobile parts to its plants and claimed an exemption for the purchase of items employed in the transfer of those component parts from facility to facility. The court held that the automobile manufacturer's packing materials were part of the integral process whereby the manufacturer produced its finished product. Therefore, the court held that automobile manufacturer's packing materials were exempt under IC § 6-2.5-5-3. The court reached that decision after finding the automobile manufacturer's separate production facilities formed an uninterrupted, singular production unit in which the petitioner's "manufacture of finished marketable automobiles [was] accomplished by one continuous integrated production process within which the transport of parts from component plants to assembly plants [was] an essential and integral part." General Motors, 578 N.E.2d at 404.

In finding that the automobile manufacturer's production process encompassed manufacturing activities performed at multiple sites, the court identified a number of significant facts. Specifically, the court found that "[t]he facts in the case as well as previous judicial findings indicate GM's production process is by nature highly integrated. The court's sole concern, however, is whether GM's manufacturer of finished automobiles qualifies as one continuous integrated production process for the purpose of exemption from sales/use tax." Id. at 402.

Footnote three gives some indication of the evidence upon which the court relied in arriving at a conclusion that petitioner GM's production was both "continuous" and "integrated." Specifically, the court found that "GM's component plant personnel collaborate with the assembly plant personnel (1) to develop new product concepts, (2) to individually design, engineer, and test the performance of new parts and packing materials, (3) to plan the layout and production processes for new parts, (4) to coordinate production schedules because delays at one plant would have an immediate effect on the other plants, and (5) to solve problems and ensure quality control." Id. at 402 n.3. In addition, the court noted that a "continuity of production exists between GM's different plants [which is] demonstrated by the standard practice of shifting certain production operations back and forth between component and assembly plants when necessary for more efficient operation." Id.

It was in the context of these particularized facts and findings that the court held that GM's manufacture of automobiles represented one "continuous integrated production process." Id. at 404. It was in the context of these particularized facts and findings that the court held that GM's assembled automobiles, and not the automobile's component parts, constituted the taxpayer's most marketable product and that the production of the "most marketable product" constituted the conclusion of GM's integrated but physically discontinuous manufacturing process.

In the instant case, Taxpayer produces aggregates at two aggregate plants in Indiana, which are sold to third parties or delivered to one of its several concrete plants. However, the majority of the aggregates Taxpayer uses in its concrete plants are bought from third parties. The aggregates, whether bought from third parties or produced at Taxpayer's aggregate plants, are stockpiled at Taxpayer's concrete plants. The aggregates that are purchased are not separately stockpiled, but are stockpiled with the aggregates that were brought from Taxpayer's gravel plants. The aggregates remain in the stockpiles until they are needed for the concrete production. The Department is unable to agree that Taxpayer's production process meets the standard set out in General Motors. There is no evidence of an integrated collaboration within Taxpayer's facilities, coordination of production facilities, of "shifting certain production operations back and forth between... plants when necessary for more efficient operation," or of collaboration between the facilities to produce new products. Id. at 402 n.3. The plants operate as two separate and distinct production processes. Therefore, as of the date of the issuance of this letter, Taxpayer is on notice that its aggregate plants and concrete plants are not part of an integrated production process.

Taxpayer maintains that the Department's determination that Taxpayer's concrete manufacturing production process did not begin until the raw materials were placed in the concrete trucks concluding that the batch plant equipment was taxable was incorrect. The Department's audit divided Taxpayer purchases for its concrete plants into a number of categories representing different areas or functions of the plant. Taxpayer has organized its protest following these categories.

A. "Movement of Aggregates."

Taxpayer asserts that its loaders, conveyors, "aggregate weigh bin," and "subsequent equipment" that are involved in the movement of the aggregates qualify as manufacturing equipment and are exempt from sales and use tax. Taxpayer believes its concrete production process, as to the aggregates, begins with the loaders and thus the conveyors, "weigh bin" and "subsequent equipment" moving the aggregates after the loaders all qualify for exemption.

Taxpayer's arguments are as follows. Taxpayer believes its concrete production process begins with the stockpiling. Taxpayer states that the aggregates are brought to the concrete plants where the aggregates are stockpiled until removed by the loaders. Taxpayer states that once the aggregates—whether brought from its aggregate plants or purchased from a third party—are stockpiled and any equipment used to maintain the stockpile is exempt. Since the loaders are used to maintain the stockpiles, the loaders should be exempt. Taxpayer explained that the loaders "stack and redistribute stockpiles to prevent gradation segregation of the aggregates." Additionally, the loaders "move aggregates from the aggregate hoppers to the cooling bins so that the aggregates can be cooled and then return to the hoppers" and "move material from the stockpiles to the hoppers to keep up

with demand that exceeds capacity of dump trucks to deliver aggregates." Lastly, Taxpayer states that because it owns a portion of the aggregates that come onto its premises, these materials are "work-in-process" to the extent the aggregates are owned by Taxpayer. Since the loaders are "moving work-in-process," the loaders should be exempt.

However, the first activity, as to the aggregates, that constitutes the beginning of Taxpayer's integrated concrete production process is the "aggregate weigh bin" which functions as a measuring device that measures and weighs the aggregates that will enter the production process. See [45 IAC 2.2-5-8\(d\)](#), Example 1 (illustrating that pharmaceutical manufacturing begins with weighing and measuring the ingredients.) See also [45 IAC 2.2-5-8\(c\)](#), Part (G) of Example 2 (listing as exempt "an automated scale process which measures quantities of raw aluminum for use in the next production step of the casting process in the foundry.")

Taxpayer is respectfully reminded that the intent of the legislature is that, in general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. IC § 6-2.5-5-3(b); [45 IAC 2.2-5-8\(a\)](#). The exemption only applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. Id. Exemption statutes are strictly construed against a taxpayer as long as the intent and purpose of the legislature is not thwarted, as provided in *Interstate Warehousing, Indiana Dep't of Revenue v. Interstate Warehousing, Inc.*, 783 N.E.2d 248, 250 (Ind. 2003). The taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. *General Motors*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

While Taxpayer owns a minority of the aggregates that arrives at the concrete plants for storage until entry into the concrete production process, this fact is not determinative as to when the concrete production process has begun. Additionally, the fact that a machine is essential to the conduct of the business of manufacturing by practical necessity does not itself mean that the machine is essential and integral to the direct production of the final product. [45 IAC 2.2-5-8\(g\)](#). Taxpayer's concrete production process, as to the aggregates, begins when the aggregates are introduced to the "aggregate weigh bin;" therefore, any transportation of the raw materials prior to its entry into the "weigh bin" is a pre-production activity. See [45 IAC 2.2-5-8\(c\)](#), Example 1 (describing a process of manufacturing aluminum pistons. It states, in relevant part, that the manufacturing process begins after the removal of the raw aluminum from storage, with the melting of the raw aluminum and the production of castings in the foundry.) See also [45 IAC 2.2-5-8\(c\)](#), Example 4 (illustrating types of equipment in Example 1 that are not exempt because of a "lack of an essential and integral relationship with the integrated production system.") See also [45 IAC 2.2-5-8\(c\)](#), Part (G) of Example 4 (listing as non-exempt "equipment used to remove raw materials from storage prior to introduction into the production process.") See also Letter of Findings 04-20090196 (November 12, 2009), 20100127 Ind. Reg. 045100012NRA (Finding this taxpayer's loader that loaded materials into a hopper was not part of the production process and was taxable as a preproduction activity.) See also Letter of Findings 04-20080141 (September 29, 2008), 20081126 Ind. Reg. 045080866NRA (Finding this taxpayer's concrete manufacturing began with its "production hopper" and that a loader used to load prior to this point and to work the stockpiles of aggregates, produced and owned by the taxpayer, were taxable as used in preproduction activities.) See also Letter of Findings 04-20070529 (August 25, 2008), 20081029 Ind. Reg. 045080792NRA (Finding this taxpayer's concrete manufacturing began with the "funnel type bins," which functioned as measuring devices that funneled and measured raw materials and did not function as storage bins).

Therefore, no matter how important the use of the loaders are to maintaining the aggregates, the aggregates, while stored in piles, have not yet been introduced to the integrated concrete production process that begins to substantially transform the raw materials into the final production. [45 IAC 2.2-5-8\(g\)](#). For example, in a analogous baked goods operation, refrigerators that are used to keep raw ingredients properly cooled are not exempt. Since the loaders are used to maintain a raw material prior to its entry into the concrete production process, the activities of the loader are a preproduction activity and are subject to tax.

Accordingly, Taxpayer's protest to the imposition of use tax on its purchase of loaders and fuel for the loaders is respectfully denied. However, Taxpayer's protest to the imposition of use tax on its purchase of the "weigh bin" and "subsequent equipment" that follows the "weigh bin" is sustained subject to the results of a supplemental audit.

B. "Measurement and Movement of Cement Products."

Taxpayer asserts that its "cement silos," "cement conveyors," "cement weigh bin," and "subsequent equipment" that are involved in the movement of the cement qualify as manufacturing equipment and are exempt from sales and use tax. Taxpayer believes its concrete production process, as to the cement, begins with the "cement silos," and thus the "cement conveyors," "weigh bin" and "subsequent equipment" that move the cement after it is released from the "cement silos" all qualify for the manufacturing exemption. Alternatively, Taxpayer argues that the "cement silos," "cement conveyors," "cement weigh bin," and "subsequent equipment" qualifies for the "environmental exemption" as defined in IC § 6-2.5-5-30.

1. "Cement Silos and Cement Conveyors."

Taxpayer argues that the "silos storing the cementitious products are exempt because storage and containment of raw materials in an integrated production process is exempt." Taxpayer cites to *Indiana Dep't of State Revenue v. American Dairy of Evansville, Inc.*, 338 N.E.2d 698 (Ind. Ct. App.1975) for the general

proposition that all storage and containment of raw materials is exempt under the manufacturing equipment exemption.

However, Taxpayer is mistaken. In *American Dairy*, the court of appeals found that, when applying the agricultural equipment exemption in effect during years 1968 through 1970 tax years to the Dairy's situation, "these containers [that] are used by Dairy to hold, measure, and convey raw materials during the production process... clearly... fall within the exemption provided by subsection (b)(1) of [IC 1971](#), 6-2-1-39, supra." *Id.* at 702 (Emphasis added). Thus, the court did not grant a broad exemption, but granted this taxpayer a limited exemption, under the agricultural equipment exemption, for containers that were used to "hold, measure, and convey" the raw materials. Moreover, [45 IAC 2.2-5-8](#)(e), which is the regulation adopted for the manufacturing exemption statute in question, states that "tangible personal property used in or for the purposes of storing raw materials or finished goods is subject to tax." Accordingly, the storage of the cement in the cement silo is a preproduction activity and does not fall under the exemption.

Alternatively, Taxpayer argues that the "cement silos" and "cement conveyors" qualify for the "environmental exemption" as defined in [IC § 6-2.5-5-30](#). Taxpayer states:

[It] is subject to strict regulations related to dust control and other environmental issues in relation to handling cementitious products in sealed pneumatic trucks and to move such products within the batch plant only using procedures with precisely controlled aeration and dust collectors. The cement silos and other equipment in the batch plants are designed to specifically meet such regulations and, as such, are exempt.

[IC § 6-2.5-5-30](#), in relevant part, provides:

Sales of tangible personal property are exempt from the state gross retail tax if:

- (1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominately used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations or standards; and
- (2) the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

(Emphasis added).

During the protest, Taxpayer presented an Indiana Department of Environmental Management ("IDEM") "Source Specific Operating Permit" letter ("Permit Letter"). "Dust collectors" and "enclosures for cement transferring operations" are listed as some of the equipment that IDEM required Taxpayer to purchase for Taxpayer to receive a "Source Specific Operating Permit" to comply with [326 IAC 2-1.1](#). While the Permit Letter requires Taxpayer to purchase and use "dust collectors" for its cement silos, the Permit Letter does not require Taxpayer to purchase the "cement silos." Moreover, the Permit Letter does not require the purchase of cement conveyors, but requires that "cement transferring operations shall be totally enclosed." Thus, IDEM required the "enclosures for the conveyors, which are transferring the cement" to be purchased and not the conveyors themselves. Since the "dust collectors" and "enclosures for the conveyors" are required by IDEM and are predominately used to meet an environmental requirement, the "dust collectors" and "enclosures for the conveyors" are exempt under the "environmental exemption" as defined in [IC § 6-2.5-5-30](#).

Accordingly, Taxpayer's protest to the imposition of use tax on its purchase of "dust collectors" for its cement silos and "enclosures for the cement conveyors" is sustained, to the extent that the audit made a determination that they were subject to tax. However, Taxpayer's protest to the imposition of use tax on its purchase of "cement silos" and "cement conveyors" themselves is respectfully denied.

2. "Cement Weigh Batchers" and "Subsequent Equipment."

Additionally, Taxpayer asserts that even if the other components in the ready mix concrete plant are not exempt, the equipment used to measure the weight of the materials and the "subsequent equipment" after the weigh measuring is exempt. Taxpayer states that the "cement is measured and, for some formulations of concrete, blended with other cementitious products (such as fly ash)... and are weighed... in the cement weigh batcher after being discharged from the silo in response to instructions from the batch computer."

As to the cement component, upon reviewing the documentation presented, the Department agrees that the first activity that constitutes the beginning of Taxpayer's integrated concrete production process is the "cement weigh bin." This bin functions as a measuring device that measures and weighs the cement that will enter the production process. See [45 IAC 2.2-5-8](#)(d), Example 1 (illustrating that pharmaceutical manufacturing begins with weighing and measuring the ingredients.) See also [45 IAC 2.2-5-8](#)(c), Part (G) of Example 2 (listing as exempt "an automated scale process which measures quantities of raw aluminum for use in the next production step of the casting process in the foundry.)

Accordingly, Taxpayer's protest to the imposition of use tax on its purchase of the "cement weigh bin" and the "subsequent equipment" that follows the "cement weigh bin" is sustained subject to the results of a supplemental audit.

C. "Measurement and Movement of Water and Chemicals."

Taxpayer asserts that the equipment that is involved in the movement of the water and chemicals qualify as manufacturing equipment and are exempt from sales and use tax. Taxpayer argues as follows:

The water used in the concrete production process is either (a) extracted from the ground by means of a

pump out of a well which has been drilled at the site, (b) is in the form of reclaimed gray water which is manufactured by reclaiming equipment or (c) is purchased from a local utility.

...

Further, transmission of water, grey water, and chemicals is essential to the assembly of materials necessary to manufacture concrete and the piping and parts for equipment to move water and chemicals is exempt pursuant to Cave Stone.

"Water is metered precisely, is heated and cooled, and is moved through the pipes so that it can be put into the concrete mixing truck at a certain rate and in a certain amount at a very specific time in the sequence of materials being put into the truck. If the water is not moved to the truck, there will be no concrete produced. Accordingly, pipes and parts for movement of water and chemicals are part of an integrated production process and are therefore exempt."

Of all the cubic yards of concrete produced at the ten ready mix plants, only 35.4 [percent] of that yardage was created using purchased water (i.e. not grey water or well water). Even if it were found that the exemption did not apply to purchased water, 64.4 [percent] of the water transmission and piping equipment would be exempt under the manufacturing exemption because production would have started at extraction (for well water) or by refining the concrete (grey water). Further, all transmission equipment after the water is measured would be exempt even if the water were purchased water.... Further, even purchased water will be blended with additional hot or cold water six months out a year [sic] so that it will be at the proper temperature for production, and the piping and valves at issue in the audit are directly used in that heating and cooling. Modifying the temperature of water is production and equipment used to do so is exempt under the production exemption. See *Midwest American Energy Resources, Inc. v. Indiana Department of Revenue*, 681 N.E.2d 259 (Ind. Tax. 1997). Once production begins at heating or cooling stage, all further activities forming part of the same integrated process are exempt.

Again, Taxpayer is respectfully reminded that the intent of the legislature is that, in general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. IC § 6-2.5-5-3(b); [45 IAC 2.2-5-8\(a\)](#). The exemption only applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. Id. Exemption statutes are strictly construed against a taxpayer as long as the intent and purpose of the legislature is not thwarted, as provided in *Interstate Warehousing*. 783 N.E.2d at 250. The taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. *General Motors*, 578 N.E.2d at 404.

1. "Well Water."

Taxpayer's argument for the exemption of the equipment transporting the "well water" is as follows: Ind. Code § 6-2.2-5-3(b) specially provides that property used in "extraction" is exempt. "Extraction" is defined in [45 IAC 2.2-5.9\(k\)\(1\)](#) [sic] as... "the removal of natural resources, minerals, and mineral aggregates from the earth, pits, or banks." After that extraction, all subsequent transportation of the water in the production process is exempt according to the rule of Cave Stone. Accordingly, the well water is a raw material which has been extracted from the ground. All further operations regarding such water are exempt from sales and use tax. Also, the pipes and movement of the well water is also exempt under the rules of Cave Stone and American Dairy.

However, even assuming, for the sake of argument, that removing water from a well would be considered "extraction" under the manufacturing exemption, this "water extraction" would not be exempt under an exemption for Taxpayer's concrete manufacturing process. The "water extraction" equipment is too far removed from Taxpayer's concrete manufacturing process. While the equipment allowing Taxpayer to acquire well water may be beneficial to Taxpayer, it is not equipment that has an immediate effect on the manufactured concrete. Taxpayer could manufacture concrete without using the "well water" equipment. Taxpayer's acquiring of "well water" is a separate system both distinct and removed from the actual manufacturing of the concrete. The "well water" equipment simply functions to process, draw, and/or transport the "well water" before the "well water" enters into the concrete manufacturing process. Accordingly, the transporting of the "well water" is a preproduction activity, as to the concrete manufacturing process, and does not fall under the manufacturing exemption. See Letter of Findings 04-20100634 (June 28, 2011), 20110928 Ind. Reg. 045110493NRA (Finding that "while water is used within the direct processing of Taxpayer's product, the water wells are used to draw and collect water and therefore constitute a pre-production activity. Consequently, the water wells are not exempt from taxation.")

Accordingly, Taxpayer's protest to the imposition of use tax on the equipment that is used in transporting "well water" is respectfully denied.

2. "Grey Water."

Taxpayer's argument for the exemption of equipment transporting the "grey water" is as follows: Grey water is obtained by processing previously produced concrete using reclaiming equipment. The equipment used to produce the grey water is exempt because of the manufacturing exemption. Because the manufacturing of the grey water is exempt, all subsequent operations in the integrated production process of concrete are also exempt, including any piping and other equipment needed to transport the grey water to the next step of production.

Alternatively, Taxpayer argues that "[t]he reclaiming equipment is also exempt pursuant to the environmental exemption."

While equipment that is used to actually extract the waste—i.e., in this case "grey water" ("waste water")—from the production process can qualify for the manufacturing exemption, any equipment that is used to collect, transport, store, or otherwise process the waste after its extraction is subject to tax. See *Graham Creek Farms v. Indiana Dep't of State Revenue*, 819 N.E.2d 151 (Ind. Tax Ct. 2004) (exempting equipment that actually remove waste from the production process, but not extending the exemption to equipment that is used to transport the waste that has been removed from production.) Since the "pipes and valves" are used to collect, store, and transport the waste water of the manufacturing process that has been extracted from the production process, the "pipes and valves" used to move the waste water are used in a post-production activity and are taxable. It does not matter that this waste water will later re-enter a new cycle of the production process. Once the waste water is removed from the production process, any transporting of the waste water is a post production activity. While the waste water may at some point re-enter Taxpayer's production process, the waste water's transport does not become a production activity until it actually re-enters the production process. Therefore, the "pipes and valves" that are used in transporting the "grey water" do not qualify for the manufacturing exemption.

Alternatively, Taxpayer argues that the "pipes and valves" that are used in transporting the "grey water" would qualify for the environmental exemption as defined in IC § 6-2.5-5-30. However, Taxpayer has not provided any information/documentation beyond its assertion that the "pipes and valves" would qualify for the environmental exemption. Without specific information about where and how the equipment is used to conform to a specific environmental regulation production process, a determination about the exempt status of the equipment cannot be made. Therefore, Taxpayer has not provided sufficient information to demonstrate that the "pipes and valves" that are used to transport the "grey water" would qualify for the environmental exemption.

Accordingly, Taxpayer's protest to the imposition of use tax on the "pipes and valves" that are used in transporting "grey water" is respectfully denied.

3. Purchased Water.

Taxpayer's argument for the exemption of equipment transporting the "purchased water" is as follows: Water is metered precisely, is heated and cooled, and is moved through the pipes so that it can be put into the concrete mixing truck at a certain rate and in a certain amount at a very specific time in the sequence of materials being put into the truck. If the water is not moved to the truck, there will be no concrete produced. Accordingly, pipes and parts for movement of water and chemicals are part of an integrated production process and are therefore exempt.

Taxpayer also argues "purchased water will be blended with additional hot or cold water six months out a year [sic] so that it will be at the proper temperature for production, and the piping and valves at issue in the audit are directly used in that heating and cooling." During the hearing, Taxpayer also stated that "water" is held in a temporary holding tank and is ultimately transported into a "boot" and the "boot" releases the water into the truck.

However, Taxpayer failed to develop its arguments and failed to provide specific information about the exact process of how and when the "purchased water" enters the production process. Without specific information about where and how the equipment is used in the production process, a determination about the exempt status of the equipment cannot be made. Therefore, Taxpayer has not provided sufficient information to demonstrate that the equipment that is used to transport the "purchased water" would qualify for the manufacturing exemption.

Accordingly, Taxpayer's protest to the imposition of use tax on the equipment that is used in transporting "purchased water" is respectfully denied.

4. Chemicals.

Taxpayer's argument for the exemption of equipment transporting the "chemicals" is as follows. "The chemicals to be added to the water as part of the concrete manufacturing process are measured at the tank. All piping subsequent to the measurement is exempt pursuant to [45 IAC 2.2-5-8\(d\)\(1\)](#)."

However, Taxpayer failed to develop this argument and failed to provide specific information about how the "measurement" takes place at the tank. Without specific information about where and how the equipment is used in the production process, a determination about the exempt status of the equipment cannot be made. Therefore, Taxpayer has not provided sufficient information to demonstrate that the "piping" that is used to transport the "chemicals" would qualify for the manufacturing exemption.

Accordingly, Taxpayer's protest to the imposition of use tax on the "piping" that is used in transporting "chemicals" is respectfully denied.

D. Software & Hardware for "Batch Control System."

Taxpayer asserts that its software and hardware for its "batch control system" qualify as manufacturing equipment and are one hundred percent exempt from sales and use tax. Taxpayer argues as follows:

The batch computer controls the equipment which measures all the materials and adjusts quantities for moisture content as well as controlling the discharge rates and sequence of all materials. The batch computer's role in the concrete manufacturing process begins when it instructs the overhead bins to drop material into the aggregate weigh bin, instructs the cement silos to drop material into the cementitious material weigh bin, and directs the water and chemical measurement devices as part of the batch sequence.

At the time that the aggregates are dropped into the aggregate weigh batcher, the moisture content is also measured so that there is not too much or too little water added at the final production stage when the materials are added to the concrete mixing truck. Accordingly, even if production does not commence until the weighting of the ingredients, as provided in [45 IAC 2.2-5-8\(d\)\(1\)](#) ex. 1, the batch computer is directly a part of that process of measuring, and is therefore 100[percent] exempt.

...

The auditor's error in connection with this category is that he assumed that measurement and movement was not exempt, and that the computer was therefore not exempt. Because measurement is clearly an exempt production activity under the regulations, the batch computer is 100[percent] exempt even if production does not begin until that point until the ingredients are measured.

The Department refers to [45 IAC 2.2-5-8\(c\)](#), which states in relevant part as follows:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

–EXAMPLES–

...

(5) A computer is used to control and monitor various aspects of the plating and surface-treatment operations in Example (1). The computer is located in a separate room in a different part of the plant from the plating and surface-treatment operations but is connected to the equipment comprising those operations by means of electrical devices. The computer equipment, including related terminals, printer, and memory, data storage, and input/output devices, is exempt because its use in this manner is an integral and essential part of the integrated production process.

(6) A computer is used to process accounting, personnel, and sales data. The computer is taxable because its use in this manner is not an integral and essential part of the integrated production process.

(7) A computer is used 40[percent] of the time to perform the functions described in Example (5) and 60[percent] of the time to perform the functions described in Example (6). The taxpayer is entitled to an exemption for the computer equipment, including related equipment such as that described in Example (5), equal to 40[percent] of the gross retail income attributable to the transaction or transactions in which the computer equipment was purchased.

...

(9) A manufacturer of printed circuit boards uses a computerized locator system to assist and direct employees in placing components in their correct positions on printed circuit boards. The system visually demonstrates the location on the board requiring a component and at the same time dispenses the appropriate component for insertion by the employee. The locator system is an essential and integral part of the integrated production process and is, therefore, exempt.

Additionally, the Department refers to [45 IAC 2.2-5-8\(g\)](#), which states in relevant part:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

–EXAMPLES–

[...]

(6) Computers which are interconnected with and control other production machinery or are used to make tapes which control computerized production machinery are exempt from tax.

(7) Computers which produce designs which are not sold as products are not exempt. Thus, computer-aided design is a nonexempt function.

(8) A computer is used 40[percent] of the time for the purpose described in Example (6) and 60[percent] of the time for the purpose described in Example (7). The taxpayer is entitled to an exemption equal to 40[percent] of the gross retail income attributable to the transaction in which the computer was purchased.

Taxpayer is respectfully reminded that the intent of the legislature is that, in general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. IC § 6-2.5-5-3(b); [45 IAC 2.2-5-8\(a\)](#). The exemption only applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. Id. Exemption statutes are strictly construed against a taxpayer as long as the intent and purpose of the legislature is not

thwarted, as provided in *Interstate Warehousing*, 783 N.E.2d at 250. The taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. *General Motors*, 578 N.E.2d at 404.

Notwithstanding, as provided in subparts (A) and (B) above, Taxpayer's integrated production process does begin at a point prior to that found by the audit, and Taxpayer has provided sufficient information to conclude that the software and hardware of the "batch computer system" is involved in these steps. Thus, as illustrated in example 8 of [45 IAC 2.2-5-8\(g\)](#), the computer software and hardware are exempt from the use tax to the extent they are used to perform the exempt functions and are taxable to the extent they are used to perform taxable functions.

Accordingly, Taxpayer's protest to the imposition of use tax on the software and hardware of the "batch computer system" is denied in part and sustained in part subject to the results of a supplemental audit determining the percent of time the hardware and software are used in an exempt manor [*sic, manner*].

E. "Portable Concrete Plant."

Taxpayer asserts that the rented "portable concrete plant" qualifies as manufacturing equipment and the rental fees are one hundred percent exempt from sales and use tax. Taxpayer argues that "[t]he concrete production process is essentially the same for the portable plant as with the fixed plants and Taxpayer incorporates all of its explanations with respect to the fixed plant in protest of the assessment of the portable plant."

Again, Taxpayer is respectfully reminded that the intent of the legislature is that, in general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. IC § 6-2.5-5-3(b); [45 IAC 2.2-5-8\(a\)](#). The exemption only applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. *Id.* Exemption statutes are strictly construed against a taxpayer as long as the intent and purpose of the legislature is not thwarted, as provided in *Interstate Warehousing*, 783 N.E.2d at 250. The taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. *General Motors*, 578 N.E.2d at 404.

Notwithstanding, as provided in subparts (A) and (B) above, Taxpayer's integrated production process for the fixed plants does begin at a point prior to that found by the audit, and Taxpayer has provided sufficient information to conclude that the portable plant seems to function similarly to the fixed plant.

Accordingly, Taxpayer's protest to the imposition of use tax on its rental of a "portable concrete plant" is denied in part and sustained in part subject to the results of a supplemental audit. The audit division is requested to review the information for the "portable concrete plant," to apply the legal conclusions concerning the production process as determined above, and make whatever adjustments to the assessment it deems appropriate.

F. "Cement Tankers" and Fuel for Tankers.

Taxpayer asserts that the "cement tankers" and sixteen percent of the diesel fuel were "used for hauling raw materials, in the form of purchased cement, [are] exempt because [the trucks are used for the] transfer of raw materials... pursuant to American Dairy which found that equipment used to transport raw materials is exempt."

Taxpayer cites to *American Dairy*, 338 N.E.2d 698 (Ind. Ct. App. 1975) for the general proposition that all storage and containment of raw materials is exempt under the manufacturing equipment exemption. As stated previously, Taxpayer is mistaken. In *American Dairy*, the court of appeals found that, when applying the agricultural equipment exemption in effect during years 1968 through 1970 tax years to the Dairy's situation, "these containers [that] are used by Dairy to hold, measure, and convey raw materials during the production process... clearly... fall within the exemption provided by subsection (b)(1) of [IC 1971](#), 6-2-1-39, *supra*." *Id.* at 702 (Emphasis added). Thus, the court did not grant a broad exemption, but granted this taxpayer a limited exemption, under the agricultural equipment exemption, for containers that were used to "hold, measure, and convey" the raw materials. Moreover, [45 IAC 2.2-5-8\(f\)\(1\)](#) states that, "Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable." (Emphasis added). While the "cement tankers" may be necessary for transporting Taxpayer's raw materials, the "cement tankers" do not have an "immediate effect" on the concrete being produced. Therefore, the "cement tankers" and the fuel consumed in the "cement tankers" are consumed in a preproduction activity and do not fall under the exemption.

Accordingly, Taxpayer's protest to the imposition of use tax on the "cement tankers" and sixteen percent of the diesel fuel is respectfully denied.

G. "Electricity."

The Department audited Taxpayer's use of electricity. The Department found that eighteen percent of the electricity used by Taxpayer from its meter(s) was used for an exempt purpose. Therefore, the Department assessed use tax on the remaining eighty-two percent of electricity used by Taxpayer. Taxpayer believes that one hundred percent of the electricity was used for exempt purposes.

If the electricity is predominately used for a purpose that is exempt from the sales and use taxes, then all of the electricity is exempt from the sales and use taxes. IC § 6-2.5-4-5(c)(3). IC § 6-2.5-3-4(a)(2) allows for a use tax exemption for property that is acquired in a transaction that is exempt from sales tax under IC § 6-2.5-5, and the property is being stored, used, or consumed for the purpose for which it was exempted.

One of those exemptions is found at IC § 6-2.5-5-5.1(b), which provides an exemption from sales and use tax for tangible personal property "if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing." Property obtained for "direct consumption as a material to be consumed in direct production" is further defined in [45 IAC 2.2-5-12\(c\)](#) as "materials [that] are directly used in the production process" and have "an immediate effect on the article being produced." Property has "an immediate effect" when it becomes "an essential and integral part of the integrated process which produces tangible personal property." [45 IAC 2.2-5-12\(c\)](#).

Also, [45 IAC 2.2-4-13](#) explains:

- (a) In general, the furnishing of electricity, gas, water, steam, or steam heating services by public utilities to consumers is subject to tax.
- (b) The gross receipt of every person engaged as a power subsidiary or a public utility derived from selling electrical energy gas, water, or steam to consumers for direct use in direct manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in [IC 6-2.5-4-5](#) shall not constitute gross retail income of a retail merchant received from a retail transaction. Electrical energy, gas, water, or steam will only be considered directly used in direct production, manufacturing, mining, refining, oil or mineral extraction, irrigation, agriculture, or horticulture if the utilities would be exempt under [IC 6-2.5-5-5.1](#).
- (c) Sales of public utility services or commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in [IC 6-2.5-4-5](#), based on a single meter charge, flat rate charge, or other charge, are excepted if such services are separately metered or billed and will be used predominantly for the excepted purposes.
- (d) Sales of public utility services and commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, or horticulture, based on a single meter charge, flat rate charge, or other charge, which will be used for both excepted and nonexcepted purposes are taxable unless such services and commodities are used predominantly for excepted purposes.
- (e) **Where public utility services are sold from a single meter and the services or commodities are utilized for both exempt and nonexempt uses, the entire gross receipts will be subject to tax unless the services or commodities are used predominantly for excepted purposes. Predominant use shall mean that more than fifty percent (50[percent]) of the utility services and commodities are consumed for excepted uses.**
(Emphasis added.)

Again, Taxpayer is respectfully reminded that the intent of the legislature is that, in general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. IC § 6-2.5-5-3(b); [45 IAC 2.2-5-8\(a\)](#). The exemption only applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. *Id.* Exemption statutes are strictly construed against a taxpayer as long as the intent and purpose of the legislature is not thwarted, as provided in *Interstate Warehousing*, 783 N.E.2d at 250. The taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. *General Motors*, 578 N.E.2d at 404.

Taxpayer is a concrete manufacturer. If over fifty percent of Taxpayer's electricity is consumed for the exempt purpose, then Taxpayer's total utility usage is exempt from the sales and use taxes. The Department conducted an audit of Taxpayer's electricity usage from the mixed usage meter(s) and made determinations about the utility usage in certain parts of the plant—i.e., the percentage used for the measurement and movement of cement and the percentage for the measurement and movement of aggregates. In applying these determinations, the exempt electricity used in concrete manufacturing processing was calculated to be eighteen percent.

Taxpayer argues that "all of the electricity in connection with the meters at issue is used in production of ready-mix concrete, and all the electricity is exempt." Taxpayer provided no information about its specific electricity usage to substantiate its claim. Notwithstanding, as provided in subparts (A) and (B) above, Taxpayer's integrated production process for the fixed plants does begin at a point prior to that found by the audit, and Taxpayer has provided sufficient information to conclude that electricity is consumed in these areas.

Accordingly, Taxpayer's protest to the imposition of use tax on its electricity is denied in part and sustained in part subject to the results of a supplemental audit. The audit division is requested to review the available information for the "electricity usage," to apply the legal conclusions concerning the production process as determined above, and make whatever adjustments to the assessment it deems appropriate.

FINDING

Taxpayer's protest to the imposition of use tax on "manufacturing equipment" is sustained in part and denied in part. Taxpayer's protest to the imposition of use tax on its purchase of the "weigh bin" and "subsequent equipment" that follows the "weigh bin" is sustained subject to the results of a supplemental audit, as discussed in subpart A. Taxpayer's protest to the imposition of use tax on its purchase of "dust collectors" for its cement silos and "enclosures for the cement conveyors" is sustained, to the extent that the audit made a determination that

they were subject to tax, as discussed in subpart B(1). Taxpayer's protest to the imposition of use tax on its purchase of the "cement weigh bin" and the "subsequent equipment" that follows the "cement weigh bin" is sustained subject to the results of a supplemental audit, as discussed in subpart B(2). Taxpayer's protest to the imposition of use tax on the hardware and software of the "batch computer system" is denied in part and sustained in part subject to the results of a supplemental audit determining the percent of time the software and hardware are used in an exempt manor [*sic, manner*], as discussed in subpart D. Taxpayer's protest to the imposition of use tax on its rental of a "portable concrete plant" is denied in part and sustained in part subject to the results of a supplemental audit, as discussed in subpart E. Taxpayer's protest to the imposition of use tax on its electricity is denied in part and sustained in part subject to the results of a supplemental audit, as discussed in subpart G. In all other respects, Taxpayer's protest is denied.

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